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QUESTION PRESENTED

Whether the terms "debt" and "claim" as defined at 11 U.S.C. section 101(11) and 11 U.S.C. section 101(4), respectively, encompass the *in rem* portion of a secured debt which remains due after the discharge in a prior bankruptcy of the *in personam* portion.

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1990

No. 90-693

CURTIS REED JOHNSON,

Petitioner,

v.

HOME STATE BANK,

*Respondent.*BRIEF OF THE AMICUS CURIAE
AMERICAN BANKERS ASSOCIATION
IN SUPPORT OF RESPONDENT

INTEREST OF THE AMICUS CURIAE

The American Bankers Association hereby respectfully submits this brief as amicus curiae in support of the Respondent with the consent of both of the parties. The signed consents of each are filed together with this brief.

The American Bankers Association is the principal national trade association of the commercial banking industry in the United States, having as members both national and state-chartered banks, located in each of the fifty states and the District of Columbia. Member banks of the Association range from the smallest of community banks through regional, super-regional and money center banks. Collectively, our

membership holds approximately ninety-five percent of domestic assets of all American commercial banks.

This is a bankruptcy case in which, as is typical, a debtor and its amici urge this Court to construe the provisions of the Bankruptcy Code "liberally" in order to carry out its remedial intent, to "alleviate the burdens faced by low and middle income consumers" (Brief of Consumers Education and Protective Association et al., at 1), to "ameliorat[e] the human costs which arise in an economic system in which business failure, with concomitant layoffs and unemployment regularly occur" (*Id.*) and to "save the debtor's home." (*Id.* at 39).

There is another side to that coin which too often escapes notice and which the American Bankers Association wishes to bring to the attention of the Court. Bankruptcy laws do not exist solely for the purpose of protecting debtors, but also to assure that there is an equitable distribution of the debtor's assets among creditors and that there are remedies against every act by which a failing debtor seeks an unequal distribution. *Merchants' National Bank v. Sexton*, 228 U.S. 634 (1913). One of the "core functions" of a bank is to lend money. *Clarke v. Securities Industry Association*, 479 U.S. 388, 409 (1987). Banks earn an income by collecting the principal and interest on the loans they make. They lose money *only* when borrowers do not pay them back. That happens too often in the current economic environment.

Personal bankruptcy filings are at a record level—over 718,000 in 1990 alone (Administrative Office of U.S. Courts, quoted in USA Today, March 19, 1991 at 1B). Personal bankruptcies together with business bankruptcies, particularly in the real estate business

(2,225 of them in 1990¹), have created serious stresses in many sectors of the financial intermediary industry. The problems of the thrift industry—which specializes in real estate lending, and especially in home mortgages—is familiar. Hundreds of such institutions have failed, hundreds more are insolvent or so poorly capitalized that they are unlikely to survive. The federally operated deposit insurance fund created to protect depositors in such institutions has proved inadequate to the task, and has required and will continue to require regular infusions of the taxpayers' money, ultimately measured in hundreds of billions of dollars, to cure the problem.²

The commercial banking industry, though somewhat less affected, has also experienced difficulties, regionally, in the real estate lending market because they are not repaid their loans. There were 169 bank failures in 1990,³ but there have been other repercussions of a declining market as well. Surviving banks have been under great pressure, both internally and from federal regulatory authorities, to cut costs. This has resulted in thousands of job losses in the industry.⁴ Similar pressures have been experienced by

¹ Kleege, *Bankruptcies Burgeon Among Banks' Real Estate Clients*, American Banker, March 19, 1991 at 8.

² Thomas, *Senate Approves \$78 Billion Measure For the Cleanup of Insolvent Thrifts*, Wall St. J., March 20, 1991 at A2.

³ Bacon, *Bruised by the S&L Fiasco, Lawmakers Now Try to Show They Are Born Again Bank Guardians*, Wall St. J., March 19, 1991 at A26.

⁴ See, e.g., Rose, *Bankers' lost innocence: Job security is vanishing*, Crain's Chicago Business, March 18-24, 1991.

the industry to tighten credit standards,⁵ especially in the real estate lending market, so much so that prospective borrowers who would otherwise have qualified for mortgages recently have not been able to do so.⁶

Even credit unions suffer from unrepaid loans. Approximately five hundred federally insured credit unions, with over \$8 billion in assets are either insolvent or inadequately capitalized.⁷

It is therefore all very well and good to be sympathetic to borrowers who, through no fault of their own, become unemployed, unable to pay their debts, and whose homes are therefore at risk. But some sympathy should be reserved as well for former bank employees who became unemployed, through no fault of their own, when too many borrowers failed to repay their loans; some sympathy should be reserved for taxpayers who, through no fault of their own, will end up—one way or the other—paying the bills left unpaid by defaulting borrowers; some sympathy should be reserved for prospective homeowners who, through no fault of their own, never get a chance to acquire a mortgage because mortgages are too risky: Too many people do not repay them. Non-debtors (non-parties to this action) have such countervailing considerations which need to be represented here. It

⁵ Nadler, *America Is Paying the Price Of Mixed Signals to Bankers*, *American Banker*, January 2, 1991 at 4.

⁶ Roosevelt, *Mortgage Crunch May Be Looming, Analyst Warns*, *American Banker*, March 25, 1991, at 1.

⁷ Rehm, *Agency Faulted in Handling of the Industry's Wounded*, *American Banker*, March 19, 1991 at 11.

is the interest of the American Bankers Association, on behalf of its members, to do so.

SUMMARY OF THE ARGUMENT

This is a fairly straightforward case of application of plain language of the relevant statute. The debtor, Petitioner in this case, received a discharge in a Chapter 7 bankruptcy proceeding. As a consequence of that, his creditors no longer had any "claim" against him as that term is defined in the Bankruptcy Code, and therefore there was nothing to be re-scheduled in a subsequent Chapter 13 proceeding. The Petitioner's reading of the plain language to the opposite effect is premised upon a faulty understanding of the nature and effect of foreclosure proceedings. When the true nature of these is properly understood, it becomes apparent that the Respondent bank in this case seeks merely to realize and benefit from its own property interest, and not pursue a nonexistent "claim" against the debtor.

ARGUMENT

The Statutory Scheme

Chapter 13 of the Bankruptcy Code sets forth a procedure whereby natural persons may receive protection from creditors by means short of liquidation. The "plans" which are provided for in Chapter 13 may designate a class or classes of unsecured "claims," modify the rights of holders of secured "claims" and provide for payments on "claims." 11 U.S.C. § 1322(b). A plan is to be confirmed if it provides that a proper value is paid on account of each unsecured "claim" and proper treatment is provided

with respect to each secured "claim". 11 U.S.C. § 1325(a).

The term "claim" is defined in the Code as either a "right to payment" or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." 11 U.S.C. § 101(4) (Emphasis supplied). A "claim" against a debtor includes a claim against the property of the debtor. 11 U.S.C. § 102(2).

When a debtor has received a discharge pursuant to 11 U.S.C. section 727, as is the case here, the effect of that discharge is to void any judgment and enjoin any efforts to enforce the personal liability of the debtor with respect to any debts discharged. 11 U.S.C. § 524. The term "debt" is defined as liability on a "claim." 11 U.S.C. § 101(11).

Under this statutory scheme, it is obvious and undisputed that the Bank has no right to payment from the debtor. Such rights as the bank may have had were clearly extinguished by the Chapter 7 proceeding three years before the filing of the Chapter 13 proceeding. If there is no right to payment from the debtor, then there is no "claim" to be covered by the subsequent Chapter 13 plan. The Tenth Circuit so held. *Home State Bank of Lewis v. Johnson*, 904 F.2d 563, 566 (10th Cir. 1990). The court was clearly correct, and its decision should be affirmed. We carry the analysis a step further, however, and examine into the question whether the Bank retains a right to payment from someone other than the debtor or a right to payment from the property of the debtor and whether that makes any difference.

Right to Payment

The Brief for the Petitioner, at 17-21, argues that the statute speaks only of a "right to payment"; it does not contain the words "right to payment from the debtor." That being the case, the Brief argues, it was wrong for the Tenth Circuit to have engrafted those words onto the statutory phrase. The Brief then goes on to allege that there are sources of payment to the Bank other than the debtor—such as the highest bidder at the sheriff's sale.

It is ironic that the Petitioner criticizes the Tenth Circuit for adding to the statute words that are not there, for in making this argument, the Petitioner deletes from the statute words that are there. The argument wrongfully equates a "payment" with a "right to payment,"⁸ and likewise flies in the face of the facts present in this case.

In this case, the Bank foreclosed on its mortgage. By common understanding, a foreclosure is a "proceeding for the legal determination of the existence of the mortgage lien, the ascertainment of its extent, and the subjection to a sale of the estate pledged for

⁸ This Court has recognized the distinction quite clearly. In *Board of Governors of the Federal Reserve System v. Dimension Financial Corporation*, 474 U.S. 361, 368 (1986), for example, the Bank Holding Company Act defined "bank" as an institution which, among other things, accepts deposits that the depositor has the legal right to withdraw on demand. The Federal Reserve adopted a regulation seeking to include within this statutory term so-called NOW accounts which were, as a matter of practice, paid on demand. This Court disallowed the regulation: "[N]o amount of agency expertise—however sound may be the result—can make the words 'legal right' mean a right to do something 'as a matter of practice.'"

its satisfaction." 55 Am. Jur. 2d *Mortgages* ¶ 553. (Emphasis supplied). To the extent that a mortgage holder may acquire a *right* to payment, it is a right which arises only from an actual sale. A "foreclosure" would not give a mortgage holder a *right* to payment if, for example, there were no bidders at all, or if the cognizant court declined to confirm the sale, perhaps due to inadequacy of the bids. *See, e.g., Ballentyne v. Smith*, 205 U.S. 285, 291 (1907). No *right* to payment accrues to the mortgage holder—indeed, no payment at all—where the mortgage holder itself is the highest and best bidder at the sheriff's sale. That is what occurred here—twice. Home State Bank was the high bidder at the sheriff's sale in December, 1985 (Brief for the Petitioner at 5) and at the sheriff's sale in November, 1990 (Brief for the Petitioner at 12).⁹ The completion of either such "sale" would not have constituted a "payment" to the Bank unless it is held, implausibly, that the Bank has made a "payment" to *itself*, which somehow constitutes the "payment" contemplated by the Bankruptcy Code. It is even more implausible to allege that the actual foreclosure proceeding which took place here somehow created an enforceable *right* of the Bank *as against itself* to compel such a "payment". The long and short of it is that a third-party bidder at a sheriff's sale *could* make a payment to the Bank for the property; the debtor *could* redeem the property; a third-party purchaser, sometime after the sheriff's sale, *could* repurchase the property from the Bank and make a payment to it, but the Bank has no *right* to require that any of

⁹ Neither "sale" was actually consummated due to the continuing litigation of which the argument before this Court is the most recent chapter.

these things happen. If the Bank concededly has no right to payment from the debtor, then there is no other identifiable person or entity from whom it has a *right* to payment, and, therefore, no right to payment at all.

The Brief for the Petitioner also suggests, at 18, that "[t]he payment *could* be made by transferring the debtor's property to a creditor" (emphasis supplied), and that a mortgage or other security interest is intended to provide "an alternate means of payment if the debtor is either unwilling or unable to otherwise pay [sic] the debt" *Id.* at 19. This argument, to the effect that the Bank has a *right* to payment from the property of the debtor, suffers from the same infirmity as outlined above: What *could* be done is a far cry from what a Bank has a *right* to require. But there are other infirmities as well.

Under the statutory scheme outlined above, a debt is a liability on a claim and a claim is a right to payment. Obviously, therefore, there must be some relationship of the "payment" to the "debt." The Petitioner even goes so far as to assert the validity of this proposition in his quotation of the *Black's Law Dictionary* definition of "payment". It is

a delivery of money *or its equivalent* in either specific property or services by one person *from whom it is due* to another person *to whom it is due . . . for the purpose of extinguishing debt.*

Brief for the Petitioner at 19 (citing *BLACK'S LAW DICTIONARY* 1016 (5th ed. 1979)).

Under that definition, urged upon this Court *by the Petitioner*, what has occurred in this case cannot pos-

sibly be described as a payment, since there is no one "from whom it is due," the debtor having been discharged; there is no one "to whom it is due" and there is no "debt" to be extinguished, since the Chapter 7 proceeding voided the Bank's ability to enforce the liability against the debtor.

In addition, the foreclosure of a mortgage is a means whereby the Bank may realize *its own* property interests. While it is clear under Kansas law that the mortgage conveys no title to the real property in question in and of itself, it is equally clear that a farm mortgage itself is a valuable property right of the Bank, recognized and protected as such under the Fifth Amendment to the Constitution. *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 590-91 (1935).

Moreover, the "property" is not necessarily the equivalent of money, as required by the Petitioner's own definition of "payment." As indicated above, a foreclosure proceeding includes an ascertainment of the extent of the lien. But if the "property" is "equivalent" to that ascertained amount, it is merely coincidental. Foreclosure of a mortgage may or may not make the Bank whole in any given case. If a bank recovers less than the full value of its outstanding credit, under ordinary circumstances it would be entitled to a deficiency judgment for the balance. That is obviously not so here. There are even circumstances in which a foreclosure results in negative value to the bank. A bank which acquires title to property by foreclosure may inadvertently find itself liable for the costs of cleaning up the environmental damage to that property under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 at

a cost in excess of the value of that property. See, e.g. *United States v. Fleet Factors Corp.*, 901 F.2d 1550 (11th Cir. 1990), cert. denied, 59 U.S.L.W. 3481 (U.S. January 14, 1991). On the other hand, a bank may take title by submitting the best bid at the sheriff's sale, hold the property essentially in fee simple for a time and then sell it as would any other owner, and retain the excess, if any, over the outstanding balance of its credit. So while ordinarily, a "payment" on a debt either reduces or eliminates the debt, there is no such effect here, no necessary relation between the debt and the so-called "payment." What actually happens during and after a foreclosure is thus so far disconnected from the "debt" itself, particularly in a bankruptcy situation, that the foreclosure could not reasonably be construed as the taking of a "payment" in the form of the "debtor's" property.

CONCLUSION

For all of the reasons set forth herein and in the Brief for the Respondent, the American Bankers Association hereby respectfully urges the Court to affirm the decision of the Tenth Circuit below.

Respectfully submitted,

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